

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Cunneen Analyst: Kristina North Bill Number: AB 81

Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: 12/07/98

Attorney: Doug Bramhall

Sponsor:

SUBJECT: Employer Public School or Vocational Institution Math or Science Teachers  
Credit/Open Enrollment Class Credit

## SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would authorize a credit to taxpayers equal to 50% of the qualified expenses paid or incurred during the taxable or income year in connection with lending a qualified employee to a high school, community college or vocational school for the purpose of teaching math or science.

Under the PITL and the B&CTL, this bill also would authorize a credit to taxpayers equal to 50% of qualified expenses paid or incurred during a taxable or income year in connection with allowing a public school teacher to attend an employer-sponsored education class by using an open enrollment space.

These credits will be discussed separately in this analysis. Except with respect to an analysis of revenue impacts, this analysis will not address the bill's changes to the Education Code, as they do not impact the Franchise Tax Board.

## EFFECTIVE DATE

The credits would apply to taxable and income years beginning on or after January 1, 1999, and before January 1, 2004.

## LEGISLATIVE HISTORY

AB 1713 (1997/1998)

## SPECIFIC FINDINGS

**Existing state and federal laws** allow a tax deduction for business expenses, including employee salaries. They also allow a deduction for charitable contributions.

**Existing state and federal laws** provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., child and dependent care credit) or to influence behavior, including business practices and decisions (e.g., research credits). However, state and federal laws do not currently allow a credit for lending an employee to a public school to teach or for allowing a public school teacher to attend an employer-sponsored class.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

2-3-99

**Existing state law** provides general rules that apply to all tax credits, unless the individual credit provision specifies otherwise. These general rules specify that any remaining credit carryover allowed by a section that has been repealed or made inoperative may be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

**Existing state law** provides general rules on the division of credits between multiple taxpayers, a husband and wife, or partners. Except as specified, no tax credit may reduce regular tax below the tentative minimum tax for alternative minimum tax purposes.

**Existing state law** provides hiring credits based on qualified wages paid to specified employees of businesses within various economic development areas. Although other limitations and restrictions may apply, qualified wages for these hiring credits cannot exceed 150% of minimum wage (which currently equates to \$8.63/hour).

**Existing state law** provides that an "eminence credential" may be issued, upon the recommendation of a school district's governing board, by the Commission for Teacher Preparation and Licensing to any person achieving prominence in a subject area taught or service practiced in California public schools. This credential authorizes teaching or the performance of services in the public schools in the subject or subject area or service and at the level(s) approved by the Commission.

#### ***LENDING QUALIFIED EMPLOYEE TO TEACH MATH AND SCIENCE***

Under the PITL and the B&CTL, **this bill** would allow a taxpayer to claim a credit equal to 50% of the qualified expenses paid or incurred during the taxable or income year in connection with lending a qualified employee to a high school, community college or vocational school for the purpose of teaching math or science.

**This credit** defines "qualified employee" as an employee whose employment specialty includes math or science. This credit further requires that a qualified employee who teaches at the high school level must have been issued, or is eligible for the issuance of, an eminence credential as defined in the Education Code.

**This credit** defines "public school" as any high school in this state that is part of a public school district or community college that is part of the Community College system.

For the purpose of **this credit**, "certified" means the issuance to the taxpayer of a service record by the public school or vocational institution verifying receipt of teaching services. The service record must contain the employee's name, dates of teaching service, number of teaching hours, and a verification signature from an authorized agent or designee of the public school or vocational institution.

**This credit** would be limited to expenses paid or incurred in connection with the wages of employees for preparation time or teaching math or science at a public school or community college located in this state.

**This credit** would be in lieu of a deduction for the amount of expenses for which this credit is allowed.

Any allowable credit amount that exceeded tax liability would be carried over until exhausted.

Since this credit does not specify otherwise, the general rules applicable to the carryover and division of credits would apply, and this credit would not reduce regular tax below tentative minimum tax.

### **Implementation Considerations**

Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- ◆ It is unclear if the author intended that "teaching" mean direct instructional services in mathematics or science pursuant to an approved curriculum. As currently written, this bill could allow an individual to qualify for this credit simply by providing information regarding how the application of math or science relates to his or her company.
- ◆ It is unclear what constitutes "preparation time."
- ◆ Further definition is needed as to which items would constitute "qualified expenses" (i.e., direct/indirect wages for classroom personnel, teaching supplies, class materials, equipment, etc.)
- ◆ A definition is needed for "vocational institution" for the department to process this credit since it is unclear whether "public" applies to vocational institution. Further, it is unclear if the author intended that this credit be allowed for teaching in a vocational institution outside of this state.
- ◆ Credits are typically used within eight years of being earned. Since this credit does not have a carryover limit, the department would be required to retain the credit carryover on the tax forms indefinitely.

### **Technical Considerations**

- ◆ The school must certify certain items for the credit to be allowed. Further language should be added to this provision to include verification that the employee has or is eligible for issuance of an eminence credential and to require the taxpayer to provide a copy of the certification to the department upon request.
- ◆ Wages paid for both teaching and "preparation time" qualify for the credit. Teaching time must be certified by the public school or vocational institution. "Preparation time" need not be certified. The lack of definition of "preparation time" together with the lack of any method to verify "preparation time" would make it impossible to audit wages paid for "preparation time."

***PUBLIC SCHOOL TEACHER TO ATTEND EMPLOYER-SPONSORED EDUCATION CLASS BY USING AN OPEN ENROLLMENT SPACE***

**This bill** would authorize a credit to taxpayers equal to 50% of qualified expenses paid or incurred during a taxable or income year in connection with allowing a public school teacher to attend an employer-sponsored education class by using an open enrollment space.

**This credit** defines "public school" as any high school in this state that is part of a public school or any community college that is part of the Community College system.

**This credit** would be in lieu of a deduction for the amount of expenses for which this credit is allowed.

Any allowable credit amount that exceeded tax liability would be carried over until exhausted.

Since this credit does not specify otherwise, the general rules for carryover and division of credits would apply, and this credit would not reduce regular tax below tentative minimum tax.

**Policy Considerations**

This bill does not require that the teacher be allowed to attend the class for no charge. As a result, the taxpayer could receive a double benefit by being allowed the credit and also receiving a fee from the teacher for attending the class.

This bill provides a credit for class attendance with no requirement that the class be directly related to the teacher's area of expertise or classroom responsibilities. If the goal of the credit is to increase teacher effectiveness, the author may wish to consider elaborating on the type of class that would qualify for the credit.

**Implementation Considerations**

Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- ◆ It is unclear if an "employer sponsored education class" would 1) include conferences, conventions, presentations, seminars, and other related events; or 2) be a "class" normally provided for the benefit of his or her employees. Also, it is unclear if the author intended to provide a credit for California public school teachers to attend employer-sponsored education classes provided outside of this state. A definition is needed to clarify the author's intent.
- ◆ It is unclear what would characterize an "open enrollment space."
- ◆ Further definition is needed as to what items would constitute "qualified expenses" (i.e., direct/indirect wages for personnel teaching the class, teaching supplies, class materials, equipment, etc.) and allocation of those expenses to the open enrollment participant.

- ◆ It is unclear if "public school teacher" would include a teacher assistant, a teacher aide or other part-time or volunteer position. To prevent disagreement between taxpayers and the department, the author may wish to specify what positions would qualify as a "public school teacher."
- ◆ Credits are typically used within eight years of being earned. Since this credit does not have a carryover limit, the department would be required to retain the credit carryover on the tax forms indefinitely.

## **FISCAL IMPACT**

### **Departmental Costs**

Until the implementation considerations addressed in this analysis are resolved, the department's costs to administer the bill are difficult to determine. However, once the considerations are resolved, the department's costs are expected to be minor.

### **Tax Revenue Estimate**

Based on data and assumptions discussed below, insignificant revenue losses are estimated to result from this bill (with enactment assumed after June 30, 1999:

Estimated Revenue Impact of <b>AB 81</b> As Introduced December 9, 1998 Years After 12/31/98 To Sunset Dates (In \$Millions)			
<b>Fiscal Years</b>	<b>1999/00</b>	<b>2000/0</b>	<b>2001/0</b>
Retired	1.2	1.2	1.3
Loaned Teachers	(1.2)	(1.1)	(1.2)
Open Enrollment	(0.3)	(0.2)	(0.2)
<b>T O T A L S</b>	<b>(0.3)</b>	<b>(0.1)</b>	<b>(0.1)</b>

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

### **Tax Revenue Discussion**

#### **A) Retired Teachers' Income**

For July 1, 1999 through June 30, 2002, this provision, by eliminating the retirement allowance reduction mandated by the State Teachers' Retirement Law, would result in additional taxable compensation reported for state tax purposes.

For this analysis, three groups of retirees were considered - those who are teaching and their income is near or above the income threshold (\$18,750 for 1998/99) for retirement purposes; those who are teaching and making less than the threshold; and finally those who would return to teach because of this change.

Based on information from the California State Teachers' Retirement System (STRS), there were nearly 140,000 retired public school teachers (all levels) as of June 30, 1998. The number of retirees formerly teaching math or science in California high schools is projected to be 5% of this total or 7,000 (calculated from data for active teachers in California public schools grades K-12 provided by the State Department of Education). Due to the limitation of earnings for retirement income purposes, it is projected that no more than 500 of these retirees are currently teaching and earning an average of \$25,000 for an average retirement allowance reduction of \$6,250.

With enactment of this bill, it is projected that an equal number (500) who are not employed elsewhere would return to teach, and about 500 of currently teaching retirees with earnings below the income limit would now exceed the limit. The average pay for these two groups is projected to be \$25,000 per year.

When a 6% average marginal tax rate was applied to these projected income amounts, additional income tax liabilities would be around \$140,000 for the first group and \$1.1 million for the second and third groups of retirees.

The loaned employee credit and the employer-sponsored classes credit proposals are identical to last year's AB 1713 (as amended April 22, 1998). The same methodology has been used with updates for more current data.

#### **B) Loaned Employee Credit**

Revenue losses would depend on the number of qualified employees loaned to California public high schools, community colleges, or vocational institutions for teaching math or sciences, the amount of total expenses incurred by employers, and their respective income tax liabilities. This estimate was based on available information pertaining to math and science teachers in California public high schools and community colleges.

- According to the California Department of Education, the number of math and science teachers in California public high schools (grades 9-12) was nearly 12,800 in full-time equivalents during the school year 1996/97. These schools project the need for an additional 1,300 math and science teachers.
- Based on an estimate from Community Colleges Chancellor's Office, public community colleges had about 4,000 math and science teachers for the 1996/97 school year, and there is a demand for approximately 400% additional teachers for these classes.
- It was assumed that loaned employees under this bill would constitute approximately 1.5% of the classroom hours corresponding to these schools' demand (over 50,000 hours), and that school districts would recommend eminence credentials for high school instruction. The interaction with the hiring of retired teachers was considered, but it was determined that the fiscal result probably would be insignificant.

- Since "vocational institutions" is not defined, it is assumed that the number and hours of loaned employees for all California "vocational institutions" would be equivalent to community college levels.
- Total qualified employer expenses for these employees are projected to be over \$2 million (based on average yearly salary of \$50,000 and \$15,000 of additional employer expenses, such as fringe benefits, payroll taxes and other costs).
- At a 50% tax credit, the order of magnitude would be losses about \$750,000 in the first year increasing to over \$1 million annually in the following years.

**C) Employer-Sponsored Classes Credit**

Revenue losses would depend on the number of open-spaces in employer-sponsored educational classes filled by California public school teachers (high school and community college level) during a school year, the employers' expenses, and their respective income tax liabilities.

This estimate was based on assumptions regarding overall participation rates for full-time and part-time teachers in California public high schools (grades 9-12) and community colleges. In addition, qualified "classes" are understood to be regular classroom settings during working hours, not special banquets, conferences, and the like.

It was assumed that 1% of all teachers (over 2,800) would be able to use open spaces in employer-sponsored classes during a school year for an average expense per attendee of \$150.

Revenue losses from a 50% credit are projected to be insignificant (at about \$200,000 per year).

The deduction offset was considered for both credit estimates.

**BOARD POSITION**

Pending.